

## Guidelines Concerning Focused Monitoring of Order Changes in Closing Auction

24 November, 2023

Tokyo Stock Exchange, Inc.

Japan Exchange Regulation

### 1. Background

In line with the Closing Auction to be introduced with the upgrade of the cash equity trading system (launch of arrowhead 4.0) planned for November 5, 2024, an order acceptance time (Pre-Closing) will be set up before the afternoon close Itayose. This will enable further reflection of supply and demand from a diverse range of investors in the closing price as well as improvement of the predictability of the closing price., and transparency in closing price formation is expected to increase. On the other hand, order price modifications and order cancellations that could affect expected matching prices in Pre-Closing without due cause not only will decrease foreseeability of closing prices and hinder smooth closing price formation but also may raise suspicions of closing price manipulation (unfair trading), such as by inducing other investors to place orders. Therefore, in introducing the Closing Auction, we will take measures to ensure smooth and appropriate closing price formation, such as by clarifying that inappropriate order placements will be subject to monitoring.

### 2. Action on inappropriate order placement

Given the need to act on inappropriate order placement that could hinder transparency in closing price formation, Tokyo Stock Exchange, Inc. (TSE) will focus on monitoring order price modifications and order cancellations that could affect expected matching prices in Pre-Closing (Including volume decreases. hereinafter "order changes") for one minute immediately before the afternoon close Itayose at 3:30 p.m. (JST).

If TSE finds an order placement that falls under the above, it will contact the trading participant to check its intention regarding the order placement. If such actions are repeated frequently, TSE may conduct confirmation of specific investment strategies and request for improvements in order placement methods, if necessary. For an order placement that may constitute closing price manipulation (unfair trading), Japan Exchange Regulation (JPX-R) will conduct a detailed investigation.

"Order changes that could affect expected matching prices" are those that fall under (1) or (2) below and exceed a certain quantity (including orders that appear to be separately placed by the same investor).

- (1) Cancellations of sell orders at prices lower than the expected matching price or buy orders at prices higher than the expected matching price (including both sell and buy orders at the expected matching price)
- (2) Modifications of sell orders from prices lower than the expected matching price to higher than the expected matching price, or buy orders from prices higher than the expected matching price to lower than the expected matching price.

### 3. Publication of types of order change considered to be based on reasonable grounds

To avoid undue restrictions on investors' investment activities, TSE has made a list of types of order change in Pre-Closing that would be considered to be "based on reasonable grounds." The following order changes will not be deemed inappropriate if the reasons are specifically and reasonably explained and TSE confirms that they were unavoidable cancellations of orders that were placed with an intent to execute.

#### Types of Order Changes Considered to be Based on Reasonable Grounds

#	Example	Notes
(1)	Unavoidable order changes due to news coming in just before Itayose that will obviously change market quotations on a large scale	- If few others reacted and only specific market participants made order changes because of the news in question, a detailed investigation may be conducted.
(2)	Order changes based on reasonable grounds of orders placed for arbitrage trading purposes between TSE-listed products or between TSE-listed products and other domestic and foreign products	- A detailed investigation may be conducted such as on the customer's order placements or prices for the relevant products. - If such actions are repeated frequently, a detailed investigation may be conducted to confirm specific investment strategies or other facts.
(3)	Order changes based on reasonable grounds of orders placed for the purpose of hedging other products	
(4)	Order changes of erroneous orders	- Even if order changes are because of erroneous orders, if such actions are repeated frequently, a detailed investigation may be conducted.
(5)	Order changes to adjust the order quantity when the order book condition changes due to orders by other market participants.	- A detailed investigation may be conducted such as confirming the triggered order or specific investment strategy. - The "triggered order" includes new orders, order price modifications and order cancellations (including volume decreases).
(6)	Order changes of orders that are unlikely to affect price formation at Itayose	- If an order change is deemed to fall under this category, TSE may choose not to make any inquiries.
(7)	Other than the above, order changes for which the reasons are explained specifically and reasonably, and	

	which TSE deems appropriate	
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**4. Other (internal rules and practices concerning trading at the close of the afternoon session)**

We have received comments, mainly from domestic institutional investors, that they are currently hardly able to participate in trading at the close of the afternoon session due to strict internal execution rules such as on cutoff times and volumes regarding trading just before the close of the session.

There is a view that the background of this practice is the result of a conservative interpretation of guidelines that were provided in the former inspection manual for financial instruments business operators, which took the form of a checklist on trading at the close of the afternoon session, among other things, while some market participants have commented that, in light of the increased liquidity at the close of the afternoon session in recent years, it is difficult to justify not trading at all at the close of the afternoon session from the perspective of best execution.

The introduction of the Closing Auction is intended to increase transparency in price formation at the close of the afternoon session, thereby further improving market convenience for all investors. TSE hopes that participants will take this as an opportunity to review their check-box type operations, such as prohibiting all trading just before the close of the afternoon session, allowing a more diverse range of investors including institutional investors to participate in trading during the period.

FAQs on " Guidelines Concerning Focused Monitoring of Order Changes in the Closing Auction"

24 November, 2023

After the introduction of the Closing Auction, will all order price modifications and order cancellations (hereinafter referred to as "order changes") just before the afternoon close Itayose be prohibited?

- This monitoring is intended not to prohibit order changes just before the afternoon close Itayose, but to prevent closing price formation from being distorted due to changes to orders that were placed with no intent to execute.
- Therefore, order changes that are unlikely to affect closing price formation (e.g., cancellations in the afternoon close Itayose of buy orders with prices lower than the expected matching price or sell orders with prices higher than the expected matching price) will, in principle, not be subject to monitoring or related inquiries.
- Even if an inquiry is made, if the reasons for the change are specifically and reasonably explained, and TSE confirms that it was an unavoidable cancellation of an order which was placed with an intent to execute, the order placement will not be deemed inappropriate.

Are order changes which will be subject to monitoring different from "spoofing"?

- This monitoring measure introduced by TSE will be to confirm mostly the intentions of order placements when order changes are made that could affect expected matching prices, from the viewpoint of ensuring transparency in closing price formation and other aspects.
- Spoofing in unfair trading (regulated under Article 159, Paragraph 2, Item 1 of the Financial Instruments and Exchange Act) is the act of placing orders with no intent to execute but for the purpose of inducing a third party to place orders, thereby manipulating market quotations to trade at favorable prices. JPX-R will continue to monitor unfair trading practices, including spoofing.

Are there specific numerical criteria for order changes that are subject to monitoring?

- TSE will internally establish certain criteria for order changes that will be subject to monitoring but will not publish them to prevent excessive restriction on investment activities and circumvention.

Will TSE also monitor changes other than those just before the afternoon close Itayose, such as those of large orders before the start of the trading session?

- JPX-R will conduct market surveillance from the perspective of unfair trading, including transactions at times other than Pre-Closing, but with the implementation of the Closing Auction, a new order acceptance time (Pre-Closing) will be held before the afternoon close Itayose, which led to concerns raised by market participants about the impact on closing price formation. This announcement is about how TSE will monitor

relevant transactions in response to these concerns.

Will order changes based on reasons other than those listed in "Types of Order Changes Considered to be Based on Reasonable Grounds" be considered inappropriate?

- The published types are only examples, and there may be cases in which an order cancellation is unavoidable even if it does not fall under any of the given types. Therefore, even if an order is subject to inquiry, it will not be deemed inappropriate if the reason for the change is explained specifically and reasonably, and TSE confirms that the case was an unavoidable cancellation of an order placed with intent to execute.

What kind of cases is assumed to be "news coming in just before Itayose that will obviously change market quotations on a large scale" in "Types of Order Changes Considered to be Based on Reasonable Grounds"?

- For example, it may be the cases that unclear information about a listed company is reported in the media, or that news occurs that affects the exchange rate or the market as a whole.

Will trading participants need to take any measures to deter customers from changing their orders just before the afternoon close Itayose?

- This monitoring is intended to prevent closing price formation from being distorted due to orders placed with no intent to execute and cancellations/modifications of these orders. Since there may be orders that were placed with an intent to execute but cancelled due to unavoidable circumstances, TSE does not intend to require trading participants to update their systems to deter order changes.
- Trading participants are requested to cooperate in properly informing customers of the monitoring and its purpose.

If a customer carries out an order change that falls under inappropriate order placement, may the trading participant who received the order be held liable?

- If TSE deems an order inappropriate in this focused monitoring, TSE may conduct confirmation as necessary, but this does not mean that TSE will immediately take measures against a trading participant who received an order from a customer which has been deemed inappropriate.

In response to this monitoring, do investors need to create restrictions on trading at the close of the afternoon session in their internal rules, operations, and other procedures?

- This monitoring is intended to prevent transparency in closing price formation from being distorted due to order changes with no reasonable ground, and not intended to create any restrictions on investment activities in accordance with actual demand such as trading based on index rebalancing.
- We would like to ask all investors to consider reviewing their internal rules and procedures for participating in

trading at the close of the afternoon session as necessary, considering that the purpose for introducing the Closing Auction is to improve transparency in closing price formation and convenience in trading at the close of the afternoon session.